

DOW THEORY LETTERS INC.

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May 10, DJIA 850.44; PTI 508; A-D ratio -22.39

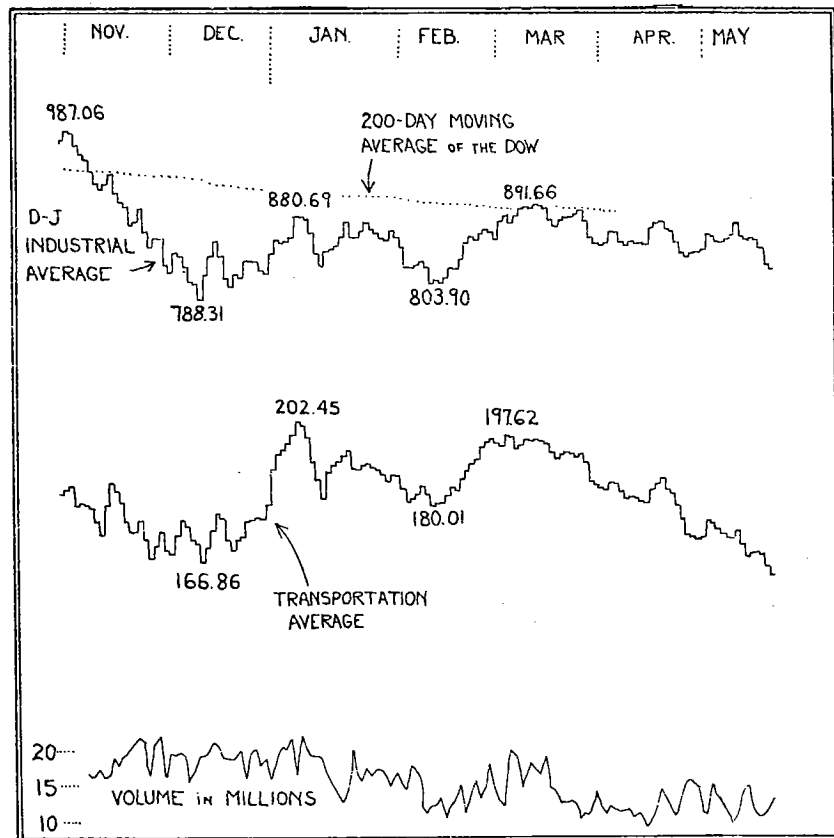
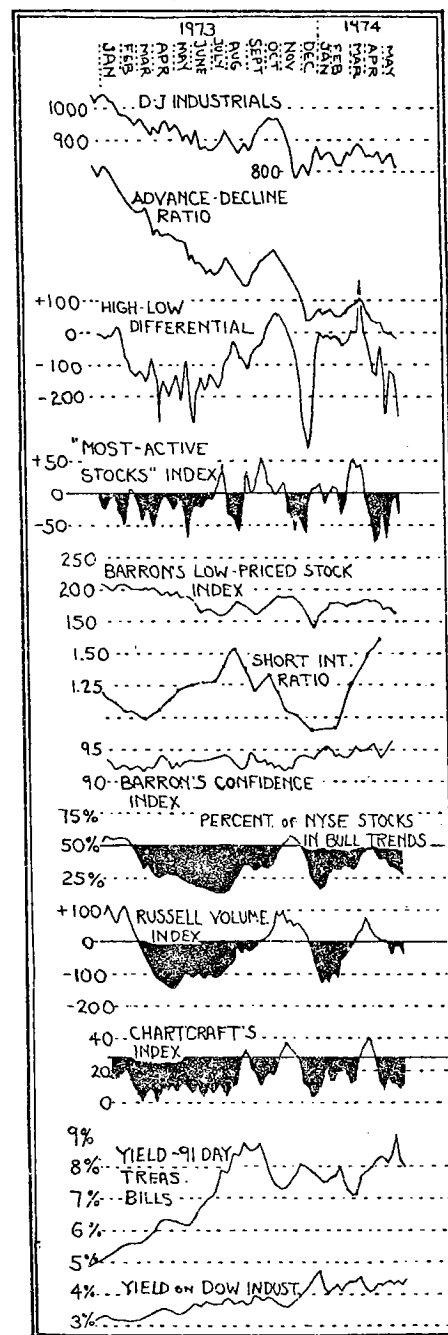
May 17, DJIA 818.84; PTI 484; A-D ratio -23.81

THE PICTURE: We are currently in the second phase of a great primary bear market, a bear market which began in February, 1966. For the benefit of new subscribers, I will repeat that bear markets (like bull markets) have three phases, and these phases are based on psychology, not on the price movement. The first phase of a bear market is the one which wipes out much of the froth and frenzy of the preceding bull market top. The first phase of this bear market occurred during 1966.

The second phase of a primary bear market is the one in which stocks go down as they reflect deteriorating economic, political and social conditions for business. The second phase of this bear market began in 1967 and has been in force ever since. The second phase of a bear market is characterized by deceptiveness, and I would venture to say that this bear market has produced the trickiest and most deceptive second phase action of any bear market on record.

Another characteristic of a bear market's second phase is "shock," and this was discussed in numerous previous Letters. Shocking news events, shocking market action, shocking action in individual stocks are all characteristic of a bear market's second phase. I wrote in Letter 586, page 3, "As I see it, the odds favor 1974 being a year of shocks, of 'unexpected' and unpleasant news, of sudden sinking spells in the market and sudden downward gaps in the prices of many stocks. I am warning my readers not to be 'amazed' and not to get caught when these events occur. This kind of action is typical of the second phase of a bear market."

Now, as we move into the latter part of the second phase, the shocks are beginning to surface. The record interest rates, the world-wide trade deficits, the oil (and now the



bauxite) offensives, the collapses in major stocks, the unmerciful smashing of such market stalwarts as IBM, Avon, Polaroid, GM and on and on. But to my mind, the most horrendous performance this year, by far, has been the near-annihilation of the bond and utility sectors of the market. Last week the D-J Utility Average broke below 74 for the first time since March, 1958. At the same time the bond market lay in ruins, with many debt issues providing such frighteningly high yields that it became clear that the market was not reflecting the mere tightness of money — it was

On the NYSE (and the other exchanges) the appearance has been that of a "leaking water bucket." The leaks continued until May 15. On the 16th the leak turned into a torrent as the Dow plunged through the 840 level. On the same day the A-D ratio broke to a new bear market low as did the Primary Trend Index. The cumulative most-active stock index (see Letter 595, page struck another bear market low, and the relentless selling pressure began (at last) to bring in increased volume.

As I watched the ominous selling of stocks last week, I had the uneasy feeling that I was seeing the destruction of capital in the US almost as in a dream. Was Howard Johnson really down to 7 $\frac{1}{4}$, was Chrysler really 16, was Texaco 25, was Woolworth under 17?

On the near-term picture the points to watch are the Industrial low of 803.90 (February 8, 1974), then the Industrial low of 788.31 (December 5, 1973), the latter being a very critical point. For Transports the Dec. 5, 1973, low of 166.86 is the level to watch. Breaking all those levels would set the stage for a descent to substantially lower levels.

PERSPECTIVE: This is my weekly chart of the three D-J stock Averages together with the advance-decline ratio. The Averages are drawn to ratio scale so that they show percentages of advance or decline. In this way, each of the Averages can be compared with the others (for instance, a 10% rise in Utilities will show as exactly the same vertical distance as a 10% rise in Industrials). Only the A-D ratio is drawn to arithmetic scale, since it does not deal with price.

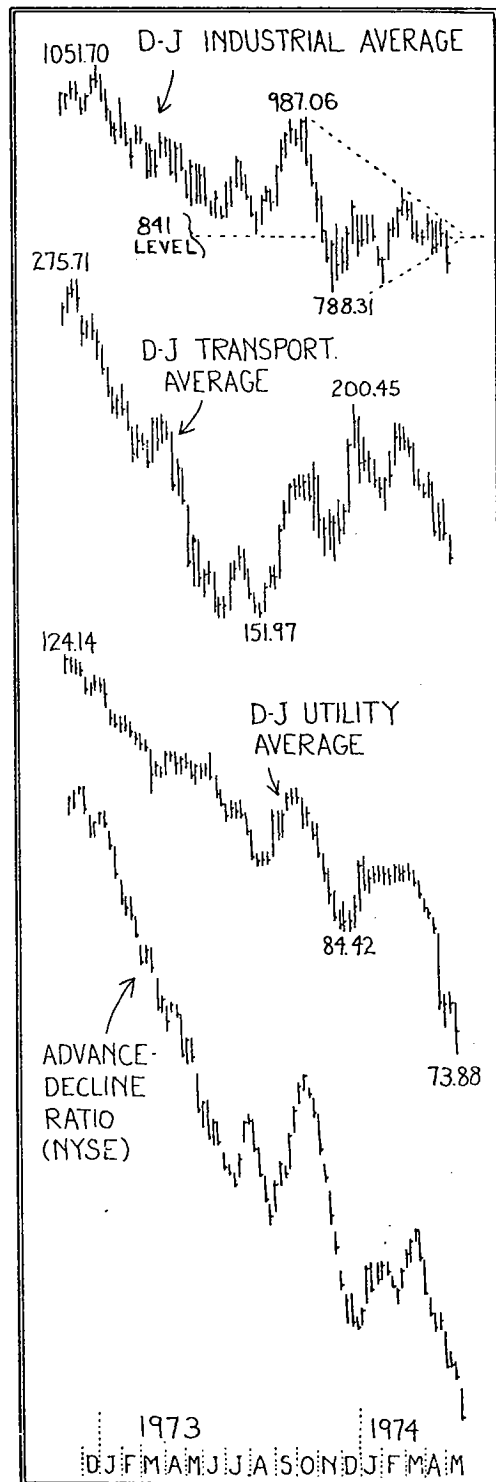
It is interesting to note that this primary bear market has been led down by the Utility Average, which has always been considered the investment-grade or "quality" Average. As I have explained in recent Letters, the Utility Average, historically, possesses bellwether characteristics. Utilities led Wall Street up all during the primary bull market of 1949-66, and they have led the market down every since then. On April 30 the Utilities hit a 16 year low of 76.30, thereby erasing over half of its entire rise from 1942 to its record high of 1965. I consider this breaking of the 50% level of the all-time Utility low to the all-time Utility high to have the most bearish implications.

Representative of the advancing or declining tendencies of the entire NYSE list, the A-D ratio acts much like an unweighted stock average. I consider the A-D ratio to be representative of the average stockholder's portfolio. As seen on the chart, the only description for this is "disaster." In fact, the years 1972, 1973 and 1974 (so far) will go down (from the standpoint of the A-D ratio) as one of the worst periods on record.

In my opinion (see Letter 595, page 3), the A-D ratio will flatten out and begin forming a horizontal base as this bear market ends. But at this point, there is no sign of a base, only the periodic corrections, then sickening plunges to new bear market lows. Thus, the majority of issues, as tracked by the A-D ratio, are following the lead of the Utilities. The descent has been shocking in its severity, extraordinary in its relentlessness, tragic in its consequences for investors.

The big question on every market student's mind has been, "Which way the D-J Industrial Average itself?" I have been of the opinion (stated many times) that Industrials would follow the rest of the market down. In view of this, I believe that last week's action must be rated as one of the classics of technical action. This is why.

In Letter 595 (April 19, 1974) I discussed the 50% Principle as applied to the D-J Averages. I noted that both Utilities and Transports were bearish under the 50% Principle in that they had broken below the 50% or halfway level of their preceding major advances. Only the Industrials remained indecisive. The last major Industrial advance took the senior Average from the 631.16 low of 1970 to the 1051.70 record high of January, 1973. I noted in Letter 595 that "this represented an advance of 420.54 points. The halfway level of the entire 1970-73 advance is 841.43."



Page 4 gave its full sell signal as it sank below 1.2. The Aaa/T-bill ratio was saying that the pressure was on the money market; something was wrong. On the week of June 29, 1973, the ratio dropped below 1.0. At this juncture (short-term) T-bill yields actually climbed above (long-term) Aaa bond yields. This is my signal for chaotic conditions in the money market (note the path of the Dow on the chart as all this was occurring).

At no time since June, 1973, has the ratio pushed above the 1.2 (the early bullish signal) level. At present, the ratio stands at 1.5 with the S & P Aaa bond yields (currently) at 7.90 yield which the yield on 91-day T-bills is around 8.0. Conclusion — the money markets continue bearish.

Finally, we have our old friend "Will Go," invented by Larry Williams (Larry used to have a stock market service but has since moved into commodities where, according to Yale Hirsch, he has made over \$1 million within a year). "Will Go" was named as such because wherever this indicator wanders, the market will later go. The basic unit of Will Go appears in Barron's weekly; it is the yield spread between the 10-High Grade Bonds and the Dow. This figure is compared with the same figure of five weeks ago. The differential between the two is calculated and then added to a cumulative total. This total is charted 10 weeks ahead of the Dow, and that is what we see on the chart (in other words, the chart shows the latest Will Go figure charted ten weeks hence).

It should be understood that Will Go deals basically with direction not extent. Secondly, Will Go is no magic formula, merely an interesting and often very helpful indicator. Third, Will Go's timing may vary; sometimes it seems to "work" on a time span of 8 weeks, then it may move to 12 weeks — but 10 is the usual.

What is Will Go saying now? This yield-oriented index predicted that the Dow would touch a rally peak in early May, then decline for 10 weeks into early July. And that's as far as Will Go's crystal ball can see at this time.

COMMENTS, MONEY, GOLD: The US is not the only nation which has seen a crumbling of its government. In other capitols, the change has simply been more complete. Over the past few months we have seen the governments of Canada, Iceland, West Germany, Portugal, France, Britain, Italy and Israel fall. Yet with inflation rampant and the world financial structure in turmoil we may be seeing a new (and perhaps hopeful) turn of events.

We are moving into the era of the Finance Ministers, the men who will have the unenviable job of telling the people that "two and two equals four." In West Germany Helmut Schmidt, former Finance Minister, is at the helm. In France we now have de Gaulle's brilliant protege, Giscard d'Estaing (also a Finance Minister). These men are good friends, they are both tough, they want to unify Europe, and they are not depending on US "leadership." If these two pro-European leaders have their way, I believe Europe may yet unify and provide a bit of monetary hope for the world. I do not believe they will bow (as did their predecessors) to the "paper money and inflation" policies of the US.

A few weeks ago Mr. Nixon ushered in Mr. Simon as his fourth (that's right, fourth) Treasury Secretary. On the day he took office Mr. Simon stated that he saw no reason why Americans should not be allowed to own gold bullion. This fits in with the previous mysterious Treasury ruling which allows Americans to own gold coins dated up to 1959 (rather than the earlier ruling allowing dating only up to 1934). I have stated all along that gold bullion would probably be made legal for US citizens during 1974. I believe we are getting very close to G-Day.

Question: What is the Arab position on gold? Answer: The Arabs have been shrewd traders for centuries. They also understand and respect gold. In my opinion they have been careful buyers of gold all year. Obviously, the Arabs want to purchase gold as cheaply as possible. They know that they are draining off (via oil sales) what is left of the tenuous liquidity in the monetary system of the Western World. They also know that their only real asset is oil, and they are not going to continue giving it away (via low prices) in the face of sterling and dollar devaluations and in the face of raging inflation in the paper currencies which they have been accumulating. It is notable, I might add, that only 10% of the total oil-producing nations' monetary reserves are now in gold. I believe the Arabs will want this ratio much higher.

Last week Saudi Arabia threatened another oil embargo if the Syrian-Israeli war is not settled. This is nonsense, and what Mr. Yamani was really saying is that the Arabs can still use the embargo. The real threat, however, is that the oil can be cut back if the West does not solve the Arab payment problem. That means coming up with acceptable currencies. Slowly, kicking and screaming all the way, the US is being pushed towards the realization that we are on the edge of a liquidity crisis. There is only one feasible way out of the debt nightmare at this time (short of hyper-inflation — or bankruptcy and a repudiation of all debts), and that is a very major rise in the price of gold.

Roughly one quarter of the West's reserves are in gold. The price of that gold must be boosted substantially, thereby automatically expanding the real reserve base for Western nations. The US objection: this would force the US to align its monetary policies with those of Europe, it would produce more inflation, and it would place gold in the central position as the core of the world's monetary system. Remember, for decades the dollar reigned supreme, and it was the US that printed dollars. The inescapable fact, the fact that the US does not want to face, is that the dollar is (and always was) simply an IOU for real money — gold. Gold is the final or ultimate value, and that truth is stronger than the President, the Congress, the US Treasury and all the politicians in America. If it weren't, would gold be four times the "official US price" of \$42.22 in the face of unrelenting US pressure?

Question: What about the IMF's desire to administer an international fund, a fund which would handle purchases of oil from the Arabs? Answer: An American dream; the Arabs stated (last week) that they would not place funds in the IMF in order to "recycle" the money back to the oil-using nations. And the reason for the Arab refusal: the Arabs do not want to lose control over their money. The second reason was Arab fear of inflation in regards to any long-term loan.

Question: If we are so near a liquidity crisis and things are so grim, why is gold still sitting in the \$160 area? Answer: I believe gold is being manipulated or carefully "fixed" at this time. When it is ready to go, I feel that it will push above the \$200 mark and probably move into the \$300 area. The question is like asking me in January, 1973, "If the gold picture is so hot, how come ASA is selling for only 18?" Well, the answer (in retrospect, of course) is that a year later ASA was 90.

As a further comment, I might add that in today's monetary world nobody and no nation moves until they are pushed (almost over the edge of the cliff). For this reason, it may well be that it will take a shocking event, a major corporate or bank failure, to set the liquidity crisis off, thereby literally forcing the monetary policy makers to deal with gold. I'll repeat that I just try to see the trend of coming events, I don't make those events. Nor do I get together with the powers above on timing.

Question: What would legalization of gold in the US do to the price of gold, gold coins and gold shares? Answer: Perhaps nothing-immediately. But I believe legalization would set the stage for a (coming) panic into gold bullion as US citizens realize that the dollar is being monetized into oblivion. Sooner or later the US monetary policies will trigger a full-scale collapse in confidence. Right now, buying of gold coins (especially low premium Austrian Coronas and Mexican Pesos) is intense! Americans are lining up at their local coin dealers and turning in their paper for gold. I believe this is going to develop into a national craze, a craze which will literally devour gold bullion from all over the world!

Legalization of gold may serve to lower the premium in gold coins over actual gold content, but that premium is already low (11% to 14% on Coronas and Pesos). The coming coin and bullion buying stampede will help send the price of gold higher, and it will also fire the bull market in gold shares. Ultimately, I expect one of the greatest rushes out of paper currency and into gold-related investments ever seen. It could well destroy the bond markets and the monetary system of the US as we know them.

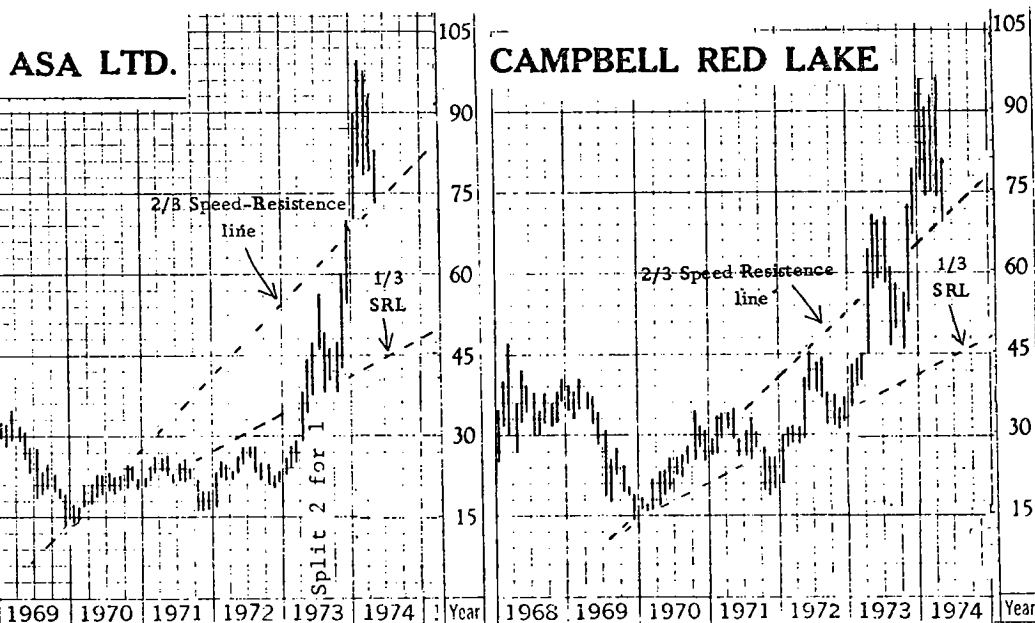
Talk about inflation, try this one for size: Last week the City of New York announced a record \$11 billion budget. The same week NYC stated that it would buy two of Con Edison's power plants for \$800 million (in order to keep Con Ed solvent). Comparison: in 1929 the US national debt was \$16 billion. We've come a long way, fellow readers — but towards what?

STOCKS: These two monthly charts show the speed-resistance concept developed by Edson Gould. A horizontal line (not shown) is drawn from the start of the move (the move began in late-1969) to the present. Then a vertical line is drawn from the high (1974) down to the base horizontal line. The vertical line (not shown) is divided into three equal parts. A dashed line (shown) is drawn, connecting the 1969 base to the first 1/3 division. This is the 1/3 speed-resistance line. A second line is connected the the 2/3 division and labeled the 2/3 SRL.

If a stock declines and holds above the 2/3 SRL on the correction, the technical situation for the stock may be tremed extremely bullish. If the correction holds above the 1/3 SRL, the situation remains bullishly intact. A breaking of the 1/3 SRL ordinarily implies that the entire rise will be wiped out (and perhaps more). So far, as can be seen on the charts, the 1974 decline has run down to, but not below, the 2/3 SRL. If Campbell and ASA can continue to hold above their 2/3 SRL, I would consider the

entire gold situation to remain highly bullish (monthly charts courtesy of Horsey, Salisbury, MD 21801).

I have stated in the past that the normal Elliot wave correction is an A-B-C affair, with an A wave down, a B wave up and a final C wave down. The mild form of Elliot correction is termed a "flat" and here the termination of the B wave may approach or even better the point at which the A wave began (see page 6 chart). In the flat the termination of the C wave is often not too far below the bottom of the A wave. That is what we may be seeing in the listed gold shares, charts of which I have included.



Page 6 I have labeled the corrections with an A, B and C on the charts. Homestake is not clearly in a flat correction, looking more like the zig-zag which is a more severe corrective formation. However, most of the golds are now "drying up" on the downside, which could mean that the golds have seen their lows. (Weekly charts of four golds courtesy of Quote, PO Box 213, Chita, KS 67201.)

Actually, it is remarkable that gold and gold shares have held this well in the face of the current monumental interest rates. I estimate that about 10% of all private gold holdings are on margin, and the margin costs probably run 15% or more. This puts a continuing pressure on bullion, so that any cracking in the current interest rate structure should take considerable pressure off gold. Actually, it is a testament to the world's fear of paper currency that gold holds as well as it does, and so far silver can be placed in the same technical category.

I include my weekly chart of the two metals, and this chart may serve to cut through all the bunk, hearsay, nonsense and rumors about gold and silver. The fact is that the two metals have held unbelievably well in a consolidation-correction phase (in the face of record interest rates) following explosive rises.

PERSPECTIVE: I have just plowed through much of my Monday mail, and I don't think I have ever seen anything like the letters, news clips, questions and comments coming in. People are very upset, they are cynical, they are angry and they are scared. Subscriptions are arriving at a record rate, not only from individuals here in the US but from corporate treasurers, banks, overseas banks and institutions, pension funds, South African brokerage houses, you name it. Nobody knows what is happening, everyone is worried, many are looking for any kind of "real safety."

My own feeling is that people are finally realizing that they have not been told the true story of what has been happening. The government has not told them, the investment services have not nor have the newspapers or periodicals. I am not saying that these sources have lied to the public. The fact is that they simply didn't see the picture, and not understanding the scope of this primary bear market they stayed optimistic (remember, Hamilton said that "People believe what they want to believe").

As I see it (and I have written the story all along) this market is headed lower, considerably lower. But as always, the timing is being extended and made more difficult by steady government inference and manipulation. This causes the analysts and investors to lose perspective, they get caught up in the daily or weekly action, and they slowly but surely get strangled by the bear. People often have the most trouble understanding the most fundamental concepts. Since 1966, when this primary bear market began, the fundamental concept has been that the world was moving into a progressively worse atmosphere for investors, and that the only stance which allowed for financial survival was out of common stocks and into all gold-related items.

I believe that we are going to see a blood-bath before this bear market is over. So far, I do not see anything which has been corrected in the economy. As usual, Wall Street is taking the first beating but the economy will follow — and it will follow into depression.

So forgetting the rallies which always occur, forgetting the spates of optimism which accompany each rally, I implore subscribers to move into a position to withstand the whirlwind which Wall Street, by its action, is predicting. I don't know how bad things may get, I don't know if things will be better or worse than what I see coming, or Harry Browne sees, or Harry Schultz sees, or Jim Dines or anyone else sees.

People write asking whether they should put stock certificates or money in Switzerland or some other "safe harbor." I say, "Why not — if you're prepared to pack up and leave the US, if need be, to get at your money!" What I do suggest now is a certain percentage of your funds (you decide) in low premium gold coins, the Mexican 50 Peso pieces or the Austrian Coronas. I think these represent a good, safe grip on real money. I believe the US government wants you to buy them, they changed the law so you can buy them (of course, you are supposed to be a "collector" not an investor), and I recommend that all subscribers put perhaps 10% to 25% of assets in these coins at this time (I can't give you the percentage that is right for you). And that does it for this week, loyal readers.

